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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957.

No. 575

L. L. CONSTANTIN & CO.,
Petitioner,

vs.

ARIZONA WESTERN INSURANCE COMPANY,
Respondent,

S & C TRADING CO., INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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vs.

ARIZONA WESTERN INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner, L. L. Constantin & Co., prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above-entitled case on July 31, 1957.

Citations to Opinions Below.

The District Court did not file an opinion. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto *infra*, p. 10, has not been officially reported.

Jurisdiction.

The judgment of the Court of Appeals was entered on July 31, 1957. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

Questions Presented.

Whether in the absence of bad faith and abuse of discretion, the judiciary should exercise its power purely on contract construction to declare dividends as opposed to the sound judgment of corporate management by action of its Board of Directors.

Statutes Involved.

The statutory provisions involved are N. J. S. 14:8-1 and N. J. S. 14:8-20. They are printed in Appendix A, *infra*, p. 9.

Statement.

L. L. Constantin & Co., a New Jersey corporation, (Constantin) was incorporated July 1, 1947. It is engaged in the engineering and manufacture of electronic components such as transistors, terminals and connector plugs, all of fine precision. From a small family held corporation it has grown to be one of the leaders in its field, by reinvesting its earnings to expand its plant facilities and increase general and new production.

On or about December 23, 1952, Constantin amended its certificate of incorporation. The amendment provided in part that:

> "The holders of the preferred stock shall be entitled to receive, and the company shall be bound to pay thereon, but only out of net profits of the company, a fixed yearly dividend of Fifty Cents (50¢) per share, payable semi-annually."

An identical provision appeared on the preferred stock certificates. Arizona Western Insurance Company, an Arizona Corporation, (Arizona) became the record holder of 10,000 shares of said stock on or about October 1, 1954.

Constantin's Board of Directors on December 28, 1954, adopted a resolution which read:

> "Resolved, that a dividend be declared on preferred stock at the interest rate of 5% to all stockholders of record on December 30, 1954, payable January 15, 1955."

In 1954 no dividends were paid on the shares held by Arizona. Arizona made a demand on Constantin for dividends and upon the refusal of Constantin instituted a suit in the United States District Court for the District of New Jersey on the basis of diversity.

The first count of Arizona's complaint related to the non-payment of the dividend declared on December 28, 1954. The second count alleged a declaration of a dividend and a non-payment thereof in 1955. The third count asserted that due to the amendment to the certificate of incorporation in December 1952, Constantin was bound to pay to Arizona out of net profits a fixed yearly dividend of 50¢ per share.

Constantin answered that in view of the fact that Arizona was no longer a stockholder, no dividends were due it but rather any alleged dividends were due the present owners of the stock. Constantin denied that any declaration of dividend had been declared in 1955 and denied also that any dividends were due in 1955 as a matter of right.

The S & C Trading Co., Inc., being the purchaser of the 10,000 shares of preferred stock on was allowed to intervene.

The District Court granted Arizona's motion on the first count and ordered Constantin to pay the declared December 1954 dividends of $5,000 plus $504.16 interest into court pending the outcome of the action between Arizona and S & C Trading Co.

The second count was dismissed, pursuant to a stipulation between Arizona and Constantin.

Constantin made a motion for summary judgment with respect to the third count, which was granted. The District Court did not hand down a decision, but on the oral argument related to the motions the court expressed its position that "notwithstanding the provision in the certificate of incorporation a dividend should be payable only when declared in the discretion and judgment of the Board of Directors." (Appendix B, *infra*, p. 13).

The court below applied the law of New Jersey to determine the issue (*Klaxon Co.* v. *Stentor Elec. Mfg. Co.*, 313 U. S. 487 (1941); *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938)), and reversed the District Court upon the authority of *Park* v. *Grant Locomotive Works*, 40 N. J. Eq. 114, 3 A. 162 (Ch. 1885); *Fourgeray* v. *Cord*, 50 N. J. Eq. 185, 24 Atl. 499 (Ch. 1892); *Stevens* v. *United States Steel Corp.*, 68 N. J. Eq. 373, 59 A. 905 (Ch. 1905); N. J. S. 14:8-20 (Appendix A hereto, *infra*, p. 9) and N. J. S. 14:8-1 (Appendix A hereto, *infra*, p. 9).

Reasons for Granting the Writ.

1. The court below in adjudicating an issue never before directly decided in the State of New Jersey rendered a decision which is in conflict with the law of that State, the prevailing law in the majority of jurisdictions and the decisions of this Court. In the absence of bad faith and abuse of discretion it has been consistently held that the judiciary will not interfere with corporate management or construe contracts so as to deprive directors of the power to preserve the Corporation entrusted to its control. *New York Lake Erie & Western Railroad Company* v. *Tom Nickals et al.*, 119 U. S. 296, 7 S. Ct. 209 (1896); *Wabash Railway Company* v. *Barclay*, 280 U. S. 197, 50 S. Ct. 106, (1930); *Gibbons* v. *Mahon*, 136 U. S. 549, 10 S. Ct. 1057 (1889); *Agnew* v. *American Ice Co.*, 2 N. J. 291, 66 A. 2d 330 (1949); *Auburn* v. *Button Works Inc.* v. *Perryman Electrical Co. Inc.*, 107 N. J. Eq. 554, 154 A. 1 (1931); *Madsen* v. *Burns Brothers*, 108 N. J. Eq. 275, 155 Atl. 28 (1931); *In re Evening Journal Association, Inc. etc.*, 15 N. J. Super. 58, 83 A. 2d 138 (1951); *Lich* v. *U. S. Rubber Co.*, 39 Fed. Supp. 675 (D. C. N. J. 1941); *Guttman* v. *Illinois Central Railroad Co.*, 91 Fed. Supp. 285 (U. S. D. C., E. D. N. Y. 1950); *Wilson* v. *American Ice Company*, 206 F. 736 (D. C. N. J. 1913); 11 Fletcher, Corporations, Sec. 5325 (1932 Edition); 18 C. J. S., Corporations, § 466; 67 A. L. R. 762.

It should be noted that at no time has there been an allegation of bad faith or abuse of discretion, which the leading cases make the necessary ingredient to compel a declaration of dividends. See, *Wilson* v. *American Ice Co.*, 206 F. 736 at page 742, "clear and unambiguous

allegation showing willful neglect or bad faith" is required; *Gibbons* v. *Mahon,* 136 U. S. 549 at page 558, "unless in a case of fraud or bad faith on their part (directors) their discretion in this respect cannot be controlled by the courts." *Guttman* v. *Illinois Central Railroad Co.,* 91 Fed. Supp. 285 (U. S. D. C., E. D. N. Y. 1950); *Stevens* v. *U. S. Steel Corp.,* 68 N. J. Eq. 373, 390, 59 A. at page 912; 18 C. J. S., Corporations, Sec. 466; 11 Fletcher, Corporations, Sec. 5325, pp. 801-802 (1932 Ed.). The court below ignored the required allegation and ruled contrary to the prevailing principle enunciated in *Lich* v. *U. S. Rubber Company,* 39 Fed. Supp. 675 (D. C. N. J. 1941).

> "The directors are charged with the management of the corporate business, and, in the absence of fraud or bad faith, their authority must be regarded as absolute. Questions of management and policy must be left to their honest judgment and discretion. *Kelly* v. *Kelly-Springfield Tire Co.,* 106 N. J. Eq. 545, 554, 152 A. 166; *Elevator Supplies Co.* v. *Wylde,* 106 N. J. Eq. 163, 150 A. 347; *Shonnard* v. *Elevator Supplies Co., Inc.,* 111 N. J. Eq. 94, 161 A. 684, 39 Fed. Supp. at page 683."

2. Clearly the question presented is of the utmost importance for the preservation of the discretion required in corporate management and the position of the judiciary to refrain from exercising control over corporate affairs. Settlement of the question by this Court is plainly in the public interest since it is likely to be presented in almost every case wherein a profit is made by a corporation and a dividend is not declared. In allowing the lower court's decision to remain undisturbed, corporate provisions either similar or dissimilar to those used in the instant case will subject corporate management to coercion by threat of suit, healthy and normal growth of industry will be im-

paired and the investment of stockholders will not receive the proper protection afforded by sound corporate management.

3. The decision of the lower court is believed to be erroneous since it is contrary to the law of New Jersey. *In re Evening Journal Association,* 15 N. J. Super. 58, 71, 83 A. 2d 138 (Ch. Div. 1951). Moreover, the decision below conflicts with the applicable decisions of this Court. *New York Lake Erie & Western Railroad Company* v. *Tom Nickals,* 119 U. S. 296, 304, 7 S. Ct. 209 (1886). Irrespective of the weight of authority the lower court reversed the District Court relying upon the authority of *Park* v. *Grant Locomotive Works,* 40 N. J. Eq. 114, 3 A. 162 (Ch. 1885). The court in effect construed the provision in the certificate of incorporation to be mandatory rather than directory. It is agreed that the construction was valid in *Park* v. *Grant Locomotive Works, supra,* since the accepted rules of construction look to the object sought to be reached by the parties to the contract or the conduct of the parties in relation to the subject matter. 57 C. J. 548; 17 C. J. S., Contracts, Sec. 328; 3 Williston, Contracts, Sec. 617 (1936 Edition). In that case there was a specific contract to convey the stock of an insolvent corporation to secured and unsecured creditors of the corporation and there was to be a gradual payment of the corporate indebtedness to the creditors. The instant case has neither the circumstances nor the conduct of the parties to substantiate the lower court's mandatory interpretation of the provisions in issue. In looking to other jurisdictions as to the general law on the subject of mandatory provisions the lower court placed reliance on *Crocker* v. *Waltham Watch Co.,* 315 Mass. 397, 53 N. E. 2d 230 (1944) (Appendix B, *infra,* note 13, p. 16), a holding

which has been severely criticized as being erroneous. 39 Ill. L. Rev. 90.

> "The courts holding goes far in interfering with the discretionary power of corporate management. The decision predicated upon contract construction, makes possible the substitution of court judgment, as to policy expediency, for that of the directors. The advisability of using this means to extend judicial control where the question of bad faith is not in issue does not meet with approval of the majority of courts." (p. 94).

Further, the lower courts decision is contrary to the well settled principle that a preferred stockholder cannot be a creditor of a corporation as to dividend in the absence of permissive statutory authority. *Field* v. *Lamson & Goodenow Manufacturing Co.*, 162 Mass. 388, 38 N. E. 1126, 27 L. R. A. 136 (Sup. Jud. Ct. Mass., 1899); 6 A. L. R. 809 et seq.; *Collins* v. *Portland Electric & Power Co.*, 12 F. 2d 671 (C. C. A. IX, 1926).

The net result of the decision below is to change by adjudication an inherent part of corporation's equity capital into funded debt. It changes the status of preferred stockholders from owners to ereditors. Paradoxically a corporation may not claim such dividends as a part of its operating expense for tax purposes.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

MYRON S. LEHMAN,
Attorney for Petitioner.

WILLIAM A. CONSODINE,
Attorney for Petitioner.

Appendix A.

N. J. S. 14:8-1.

Every corporation organized under this title may create two or more classes of stock, any of which may be stock with par value or stock without nominal or par value, with full, limited or no voting powers, of such classes, with such designations, preferences, relative, participating, optional or other special rights, qualifications, limitations, or restrictions thereof, as shall be stated and expressed in the certificate of incorporation, but no stock with par value shall be created entitling the holders thereof to receive preferred dividends thereon in excess of eight per cent per annum.

The power to increase, decrease or otherwise adjust the capital stock as in this title elsewhere provided shall apply to all or any of the classes of stock.

No corporation shall have the power to issue any stock with par value at less than the par value thereof.

N. J. S. 14:8-20.

Unless otherwise provided in the certificate of incorporation, or in a by-law adopted by a vote of at least a majority of the stockholders, the directors of every corporation organized under this title may, in their discretion, from time to time, fix and vary the amount of the working capital of the corporation and determine what, if any, dividends shall be declared and paid to stockholders out of its surplus or net profits. Dividends may be declared and paid in capital stock with or without par value.

Appendix B.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,195

ARIZONA WESTERN INSURANCE COMPANY,
Appellant,

v.

L. L. CONSTANTIN & Co.

and

S & C TRADING Co., INC., a corporation (intervenor)

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY

Argued June 6, 1957

Before BIGGS, *Chief Judge,* and GOODRICH and KALODNER, *Circuit Judges.*

Opinion of the Court.

(Filed July 31, 1957)

By BIGGS, *Chief Judge.*

Arizona Western Insurance Company (Arizona) instituted this suit against L. L. Constantin & Co. (Constantin) to recover dividends on 10,000 shares of preferred stock in Constantin held by Arizona and authorized by the December 2, 1952 amendment to Constantin's certificate of incorporation.[1] This provided in pertinent part that "The holders of the preferred stock shall be entitled to receive, and the Company shall be bound to pay thereon, but only out of the net profits of the Company, a fixed yearly dividend of Fifty Cents (50¢) per share, payable semi-annually." An identical provision appeared in the preferred stock certificate. Arizona was the record holder of the stock from on or about October 1, 1954 to on or about February 1, 1956.[2]

Constantin's Board of Directors on December 28, 1954 adopted a resolution which read: "Resolved, that a dividend be declared on preferred stock at the interest rate of 5% to all * * * stockholders of record on December 30, 1954, payable January 15, 1955."[3] At the declared rate Arizona as the holder of 10,000 shares of preferred stock was entitled to dividends of $5,000. Constantin paid dividends on certain shares of its preferred stock but nothing was paid on the shares held by Arizona.

In 1955 no dividend was paid to any holder of preferred stock.

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[1] The amendment authorized the issuance of 50,000 shares of preferred stock having a par value of $10.00 per share.

[2] Stipulated pursuant to Fed. R. Civ. P. 76.

[3] The declared rate of 5% was equivalent to the 50¢ per share provided in the charter and stock certificate.

After a demand for dividends Arizona instituted suit on the basis of diversity.[4] The first count of the amended complaint related to the non-payment of the dividend declared on December 28, 1954. The second count alleged a declaration of a dividend and non-payment thereof in 1955. The third count alleged that under the terms of Constantin's amended certificate of incorporation and the preferred stock certificate, Constantin was bound to pay to Arizona out of net profits a fixed yearly dividend of 50¢ per share, payable semi-annually, and that net profits were available for the payment of such a dividend. Arizona alleged that it demanded payments of the dividends, that payment was refused and that it is entitled to a judgment in the amount of $5,000 plus interest for the dividend declared in 1954 and not paid to Arizona and to a judgment in the amount of $5,000 plus interest for the unpaid dividend which, it is alleged, Constantin was bound to pay in 1955, there being net profits available.

Constantin answered in substance that Arizona was no longer a stockholder and that therefore no dividends were due it; that any alleged accrued but unpaid dividends were due to the present owner of the preferred stock, not Arizona; and, while admitting the declaration of a dividend on December 28, 1954, Constantin denied that any dividend had been declared in 1955, and denied also that any dividends were due in 1955 as a matter of right.

S & C Trading Co., Inc., was permitted to intervene as a party plaintiff on the basis of a contention that as transferee of 10,000 shares of the preferred stock held by Arizona, it was entitled to all dividends and rights to dividends declared and unpaid, or undeclared.[5]

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[4] Arizona is an Arizona corporation and Constantin is a New Jersey corporation.

[5] From answers to interrogatories and from facts set out in the agreed statement, it appears that Arizona sold its 10,000 shares to S & C Trading Co. on January 31, 1956, and that S & C Trading Co. became record holder of the stock on or about February 1, 1956.

Arizona moved for partial summary judgment on the first count of the amended complaint and this motion was granted. In view of the intervention and claim to dividends by S & C Trading Co., the court below ordered Constantin to pay the December 1954 dividend of $5,000 plus $504.16 interest into the registry of the court to await the outcome of the action between Arizona and S & C Trading Co.

Pursuant to a stipulation between Arizona and Constantin, the action based on the second count was dismissed. An examination of the minutes and books of account of Constantin showed that no dividend was declared or paid to the owners of preferred stock for the calendar year of 1955.

Constantin's motion for summary judgment, or judgment on the pleadings in the alternative, with respect to the third count of the amended complaint, was granted, and Arizona's cross-motion for summary judgment addressed to the third count was denied. The court below handed down no opinion explaining the reasons which caused it to take the action it did on the motions directed to the third count but on the occasion of oral argument on the motions the court expressed the view that "notwithstanding the provision in the certificate of incorporation, a dividend should be payable only when declared in the discretion and judgment of the Board of Directors."[6] The clerk was directed to enter a final judgment dismissing the third count with prejudice, the court below expressly determining that there was no just reason for delay in the entering of such a judgment. Rule 54(b), Fed. R. Civ., P., 28 U. S. C.

This appeal relates only to the lower court's determination as to the third count of the amended complaint. As we have indicated this count alleged that Constantin was contractually bound by the provisions of its amended certi-

[6] Stipulated pursuant to Fed. R. Civ. P. 76.

ficate to pay a dividend for 1955, net profits being available.[7]

Constantin contends that if this court compels the payment of a dividend, absent fraud or bad faith on the part of the Board of Directors, it will be interfering in the management and internal affairs of the corporation; that the compelling of a payment of a dividend would change the status of Arizona from a shareholder to a creditor; and that a suit to compel a declaration of a dividend is a class action and Arizona does not allege that it sues on behalf of other stockholders similarly situated.

Since Arizona's claim is asserted against Constantin, a New Jersey corporation, and is based on the certificate of incorporation granted that corporation under the corporation law of that State, the law of New Jersey must determine the issues before us. *Klaxon Co.* v. *Stentor Elec. Mfg. Co.*, 313 U. S. 487 (1941); *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938). Does the law of New Jersey support the conclusion that the provisions of the amended certificate of incorporation and the preferred stock certificate contractually bind Constantin to pay a dividend for 1955, net profits being available for the purpose? We conclude that it does.

The few New Jersey cases relevant to the issue are not too helpful. In *Park* v. *Grant Locomotive Works*, 40 N. J. Eq. 114, 117-18, 3 Atl. 162, 165 (Chancery 1885), the court employed strong language to point out that the discretion of the directors in the disposition of net profits was limited by the contract entered into between the stockholders and creditors to lift a receivership and to enable the insolvent corporation to resume its business. Payment was

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[7] Arizona, in the event of reversal by this court, agrees that Constantin should pay the 1955 dividend into court to abide the outcome of the claim by S & C Trading Co. This would be similar to the disposition already made of Arizona's claim to the 1954 dividend under the first count of its amended complaint.

ordered. In the cited case the complainants, seeking payment of the larger dividend, were stockholders who had been creditors. In truth, the obligations sued on possessed some of the characteristics of a debt as well as of a stock. The decision of the Court of Chancery was affirmed *per curiam* by the Court of Errors and Appeals in 45 N. J. Eq. 244, 19 Atl. 621 (1888).

In *Fougeray* v. *Cord*, 50 N. J. Eq. 185, 24 Atl. 499 (Chancery 1892), the court recognized its power to compel a corporation to pay a dividend from profits but indicated it would not have ordered such a step had not the managers of the corporation perpetrated a fraud on the complainant. The decree of the Vice-Chancellor was reversed, *sub nom. Laurel Springs Land Co.* v. *Fougeray,* 50 N. J. Eq. 756, 26 Atl. 886 (1893), but the Court of Errors and Appeals recognized the power of the Court of Chancery to order the directors of a trading corporation to pay a dividend from profits when they refused to do so without justification.

The language employed by the Court of Chancery in *Stevens* v. *United States Steel Corp.,* 68 N. J. Eq. 373, 377-78, 59 Atl. 905, 907 is pertinent. The Vice-Chancellor said: "Subject of course, to provisions in the charter, and also to the by-laws of the company, it is for the directors to say whether profits shall be distributed to the stockholders, or retained for the purpose of the corporate business." In *Wilson* v. *American Ice Co.,* 206 Fed. 736, 738 (1913), the United States District Court for the District of New Jersey stated, "It is well settled, that in the absence of statutory provisions, the granting of dividends from the profits of a trading corporation is in the discretion of the directors, subject to the intervention of a court of equity for improper refusal."

The decisions referred to are the only New Jersey cases relevant to the issue before us which our research and the diligence of counsel have uncovered. Nonetheless,

it is our duty where "the State law supplied the rule of decision to ascertain and apply that law 'even though it has not been expounded by the highest court of the State.' Fidelity Union Trust Co. *v.* Field, 311 U. S. 169, 177-78 (1940)." *Brown* v. *Moore*, F. 2d , (3 Cir. 1957).

We appreciate the reluctance of courts to construe provisions relative to the declaration of dividends in such a way as to hold that the directors are bound in certain circumstances to declare dividends. But the shareholder has the right to have his contract enforced, and, if the contract as expressed in the certificate of incorporation and the stock certificate, require the construction that dividends are mandatory under specified circumstances the courts can adopt no other construction of the contract between the corporation and the stockholder. See *Crocker* v. *Waltham Watch Co.*, 315 Mass. 397, 53 N. E. 2d 230 (1944).

The amended certificate of incorporation in the case at bar provides in pertinent part that, "The holders of the preferred stock *shall be entitled to receive*, and the Company *shall be found to pay* thereon, but only out of the net profits of the Company, a fixed yearly dividend of fifty cents (50¢) per share, payable semi-annually."[8] Identical language is found in the preferred stock certificate.[9] Words could not more clearly or plainly manifest that Constantin agreed to be bound to pay dividends where net profits were available for the purpose. We will not hold that the words were employed as a bait to prospective purchasers of preferred stock.

The statutes of New Jersey do not preclude a corporation from setting provisions in its charter providing for the

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[8] Italics added.

[9] The pertinent part of the amended certificate of incorporation, and the preferred stock certificate are set out in the agreed statement filed pursuant to Fed. R. Civ. P. 76.

mandatory payment of dividends.[10] New Jersey Statutes Annotated 14:8-20 states that, "*Unless otherwise provided in the certificate of incorporation,* or in a by-law * * * the directors of every corporation organized under this title may, in their discretion, from time to time * * * determine what, if any, dividends shall be declared and paid to stockholders out of its surplus or net profits * * *"[11] The language we have italicized shows that the discretion ordinarily possessed by the directors in respect to the declaration of dividends may legally be contracted away under the law of New Jersey.

The explicit language of Constantin's amended certificate of incorporation and of its preferred stock certificates and the provisions of the New Jersey statutes themselves cause us to conclude that the Supreme Court of New Jersey, did that tribunal have the instant case before it, would hold that the payment of a dividend for the year 1955 was required of Constantin if there were net profits available. This conclusion is not incongruous in the light of the general law.[12] Dealing with mandatory dividends, and is supported by the decisions of strong courts of other States.[13]

The only question that remains is whether Constantin had net profits for the year 1955 out of which dividends

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[10] N. J. S. 14:8-1 authorizes a corporation to create two or more classes of stock with such "designations, preferences * * * or other special rights" as expressed in the certificate of incorporation.
N. J. S. 14:8-2 provides in part that, "The holders of preferred or special stocks shall be entitled to receive dividends at such rates, on such terms, and at such times as shall be provided in the certificate of incorporation * * *"

[11] Italics added.

[12] 12 Fletcher, Cyc. Corp., § 5447.1 (1957 Revision); 18 C. J. S., Corporations § 223; 13 Am. Jur., Corporations § 696; Annotation, 27 A. L. R. 1073, 1089-92.

[13] New England Trust Co. v. Penobscot Chemical Fiber Co., 142 Me. 286, 50 A. 2d 188 (1946); Crocker v. Waltham Watch Co., 315 Mass. 397, 53 N. E. 2d 230 (1944); Lydia E. Pinkham Medicine Co. v. Gove, 303 Mass. 1, 20 N. E. 2d 482 (1939); Warburton v. John Wanamaker Philadelphia, 329 Pa. 5, 196 Atl. 506 (1938); Burk v. Ottawa Gas & Elec. Co., 87 Kan. 6, 123 Pac. 857 (1912); Cratty v. Peoria Law Library Assn., 219 Ill. 516, 76 N. E. 707 (1906); Wisconsin Lumber Co. v. Green & Western Telephone Co., 127 Iowa 350, 101 N. W. 742, 745 (1904); Wood v. Lacy, 54 Hun 550 (Sup. Ct. 1st Dept. 1888), aff'd 124 N. Y. 83, 26 N. E. 338 (1891).

could have been paid.[14] Arizona served interrogatories on Constantin requesting the latter to reveal the aggregate of its "net profits (whether denominated 'earned surplus' or otherwise)" as of December 31, 1954 and 1955. Constantin replied that "total surplus" on the respective dates was $712,821.30 and $833,923.45, but added "whether earned or contributed is not shown." Arizona thereupon obtained an order directing Constantin to "Reply to * * * the interrogatories by stating the aggregate of defendant's net profits, whether denominated earned surplus or otherwise * * *" Pursuant to the order Constantin gave the same figures and described them as "earned surplus." It would appear that Constantin was attempting to evade a straightforward answer to Arizona's interrogatory, an evasion which the court below should not have tolerated. A corporation is no more entitled to avoid the discovery processes of a United States district court than is an individual. Corporate officers must be compelled to answer proper questions and if they refuse to respond to the proper orders of the court appropriate legal process should be applied to them. At the argument before us counsel for Constantin wisely abandoned the quibble and conceded in open court that "net profits" were available.

The order of the court below granting summary judgment to Constantin will be reversed. The case will be remanded with the direction to enter judgment in favor of Arizona in such amount as the facts and the law shall require.

A true Copy:

Teste:

Clerk of the United States Court of Appeals for the Third Circuit.

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[14] The amended certificate of incorporation and the preferred stock certificate require payment only out of "net profits." This is in conformity with N. J. S. 14:8-19 which prohibits directors from paying dividends except from surplus "or from the net profits arising from the business of the corporation." The expression "net profits" as used in the statute has been construed not to be synonymous with annual net earnings but to be the "clear pecuniary gain remaining after deducting from the gross earnings of the business the expenses incurred in its conduct, the losses sustained in its prosecution, and the capital invested." Lich v. United States Rubber Co., 39 F. Supp. 675, 681 (D. N. J. 1941), aff'd on opinion of district court, 123 F. 2d 145 (3 Cir. 1941). See also Mengel Co. v. Glen, 50 F. Supp. 765, 769 (W. D. Ky. 1943).